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One minute with...
Isobel d'Inverno, head of corporate tax, Brodies

# TAX JOURNAL

Insight and analysis for the business tax community

Issue 1391 | 16 March 2018

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# From the editor

The Spring Statement saw Philip Hammond 'break the chancellorial mould' by largely resisting the temptation to announce new tax changes, Chris Sanger reports (page 8). That's not to say, though, that the day was entirely devoid of interest for the tax profession: numerous tax consultations and calls for evidence were published (see the report at page 12). Many of these had a focus on compliance issues arising from the 'new' economy, as Jason Collins explains (page 10). Perhaps the most eagerly awaited of the published documents was the government's updated position paper on corporate tax and the digital economy. Pending a long term multilateral solution, options are suggested for an interim tax on user-based revenues – but 'none of these approaches is likely to be simple, and a key risk will be ... business models will change so that new businesses will no longer be within scope' (Heather Self, page 9). And what about the wider economy? The chancellor might be feeling 'positively Tiggerish', but there's no doubting that 'the UK remains in the slow lane of global growth' (John Hawksworth, page 11).

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## Spring Statement: update on corporate tax and the digital economy

The chancellor delivered his Spring Statement on 13 March, alongside which the government published an update on its position paper, *Corporate tax and the digital economy*, and number of consultations and calls for evidence.

Following comments received on the position paper published at Autumn Budget 2017, the government has refined its views in an updated paper, which looks more closely at the key aspect of how user participation creates value for certain digital businesses. It also looks at issues around the proposed interim measure of a tax on the revenues of digital businesses who derive significant value from UK user participation.

The updated paper sets out:

- a more detailed explanation of how user participation is considered to create value for certain digital businesses, including generation of content and engagement with platforms, representing a contribution to the brand;
- a possible approach for incorporating user-created value into the international tax rules: the government sees justification in some reallocation to user jurisdictions of the profits recorded by those companies in a group that receive the 'residual profits' of the business, that is, profits after payments to service providers; and
- questions around the detailed design of a revenue-based interim measure, defining businesses and revenues in scope, identifying user location, the possibility of taxing net revenues for conduits and pass-throughs.

The government's position is summarised as follows:

- the participation and engagement of users is an important aspect of value creation for certain digital business models;
- the preferred and most sustainable solution is reform of the international corporate tax framework to reflect the value of user participation; and
- in the absence of such reform, there is a need to consider interim measures such as revenue-based taxes.

In a written statement, the chancellor set out a summary of the consultations published on the day, as well as an announcement of further consultations planned for the coming months. Those published on 13 March include:

- the role of online platforms in ensuring tax compliance;
- cash and digital payments in the new economy;
- allowing entrepreneurs' relief for gains before dilution;
- EIS knowledge-intensive funds;
- tax relief for self-funded work-related training;
- extending the security deposit regime to CT and CIS;
- options for the VAT registration threshold;
- VAT split payment for online sales;
- effect of VAT and APD on tourism in Northern Ireland; and
- using the tax system to address single-use plastic waste.

See the report at page 12.

# Business taxes

### NIC rates, limits and thresholds

The Social Security (Contributions) (Rates, Limits and Thresholds Amendments and National Insurance Funds Payments) Regulations, SI 2018/337, specify the increased NICs rates, limits and thresholds to apply from 6 April 2018 for: class 2 rate and small profits threshold; class 3 rate; class 4 lower and upper profits limits; class 1 lower and upper earnings limits; class 1 primary and secondary thresholds; and class 1 upper secondary thresholds for employees under 21 and apprentices under 25.

# VAT and indirect taxes

### EC infringement proceedings on VAT zero-rate and customs duty losses

The European Commission has sent letters of formal notice to the UK, requesting a response within two months on two matters:

- VAT zero-rating for certain commodity derivatives under the UK's Terminal Markets Order; and
- the UK's refusal to pay over more than €2bn in customs duty lost through fraud.

The VAT (Terminal Markets) Order, SI 1973/173, allows a specific VAT zero rate for derivative transactions in spots, futures (and options on) commodity contracts, when traded on an exchange. HM Treasury said in a statement responding to the Commission's notification that: 'the letter does not have any immediate effect on UK tax law and the matter will be subject to the normal infraction process, which is open to challenge'.

The customs duty proceedings concern the UK's failure to take action to prevent fraud relating to the importation of textiles and footwear originating in the People's Republic of China since 2007. According to the European Commission, this is despite the UK 'having been informed of the risks of fraud and having been asked to take appropriate risk control measures'. The Commission calculates that losses to the EU budget amount to €2.7bn (minus collection costs) between November 2011 and December 2017.

### Fulfilment house due diligence scheme

The Fulfilment Businesses Regulations, SI 2018/326, replace and revoke SI 2018/299, laid on 6 March, which contained errors. The regulations set out the detailed rules for operation of HMRC's new fulfilment house due diligence scheme.

### Aviation EU ETS

The Greenhouse Gas Emissions Trading Scheme (Amendment) Regulations, SI 2018/306, implement three changes to the aviation EU ETS with effect from 31 March 2018, following amendments to the EU regulation. The changes:

- extend the temporary 'stop the clock' derogation which restricts reporting obligations to intra-EEA flights until 2023;
- lower the simplified reporting threshold to operators emitting less than 3,000 tonnes of $CO_2$ per annum on intra-EEA flights; and
- extend the exemption for small operators emitting less than 1,000 tonnes of $CO_2$ per year until 2030. BEIS consulted on a draft of these regulations during December and January.

### Welsh landfill disposals tax

The Tax Collection and Management (Landfill Disposals Tax Records) (Wales) Regulations, SI 2018/276, set out the records landfill operators in Wales must keep for the purposes of landfill disposals tax with effect from 1 April 2018.

# International taxes

### EC highlights harmful tax practices in latest country reports

The European Commission's 2018 'European semester winter package' has identified harmful tax practices in seven EU member states. A new taxation paper also provides evidence of aggressive tax planning structures in use.

The European semester contains individual country reports providing an annual analysis of the economic and social situation in each of the member states. For the first time in the context of these analyses, 'the Commission is stressing the issue of aggressive tax planning in seven EU countries: Belgium, Cyprus, Hungary, Ireland, Luxembourg, Malta and The Netherlands', said taxation commissioner Pierre Moscovici.

The reports outline:

- *Ireland:* absence of anti-abuse rules for the exemption from withholding taxes on dividend payments made by companies based in Ireland;
- *Luxembourg:* absence of withholding taxes on royalty and interest payments and the lack of some anti-abuse rules;
- *The Netherlands:* absence of withholding taxes on dividend payments by co-operatives, the possibility for hybrid mismatches using the limited partnership, absence of withholding taxes on royalties and interest payments, and the lack of anti-abuse rules;
- *Belgium:* patent box and delay in transposing ATAD into national law;
- *Cyprus:* tax rules on corporate tax residency, absence of withholding taxes on dividend, interest and royalty payments by Cyprus companies, risks associated with the design of Cyprus's notional interest regime, and the lack of anti-abuse rules;
- *Hungary:* relatively high capital inflows and outflows through special purpose entities having little or no effect on the real economy, absence of withholding taxes on dividend, interest, and royalty payments made by companies based in Hungary, and patent box;
- *Malta:* planned notional interest deduction regime, absence of withholding taxes, and the lack of anti-abuse rules.

The Commission has also published a new taxation paper on 'aggressive tax planning indicators', which provides economic data on tax planning structures in use in EU member states. The report groups these structures into three types:

- via interest payments;
- via royalty payments; and
- via strategic transfer pricing.

### Council approves new EU reporting rules for tax planning intermediaries

ECOFIN ministers have agreed the European Commission's proposal for new disclosure and reporting rules for intermediaries, such as tax advisers, accountants and lawyers, involved the design and promotion of 'aggressive' cross-border tax planning schemes.

The new reporting requirements, introduced through an amendment to the administrative cooperation directive, will apply from 1 July 2020, with member states obliged to exchange information every three months.

The final version of the directive includes a revised hallmark for payments to connected companies in low-tax jurisdictions, which will now apply to jurisdictions with a zero or 'almost zero' corporate tax rate, removing references linking the hallmark to a rate lower than 35% of the average corporate tax rate in the EU.

Five hallmarks will define what is potentially an aggressive tax planning scheme:

- generic arrangements such as those in which the intermediary is entitled to receive, for example, a fee based on the amount of the tax advantage derived from the tax scheme;
- specific hallmarks linked to the 'main benefit test' of obtaining a tax advantage;
- cross-border transactions between related parties, designed to exploit jurisdictions where the corporate tax rate is zero, or 'almost zero';
- any scheme designed to circumvent EU legislation or agreements on automatic exchange of information; and
- schemes not conforming to the arm's-length principle or the OECD's transfer pricing guidelines.

### OECD model disclosure rules for CRS avoidance schemes

The OECD has published a set of model rules, which would require advisers and intermediaries to disclose information to the tax authorities about schemes designed to avoid CRS reporting obligations or hide beneficial owners. This responds to a request by G7 finance ministers to develop rules based on the approach in BEPS Action 12.

These model disclosure rules will be submitted to the G7 presidency and are part of a wider strategy to prevent CRS avoidance. The OECD comments that many countries are 'actively considering' introduction of the rules and that the CRS itself requires participating jurisdictions to have rules in place to prevent avoidance arrangements.

### Ireland appoints escrow agent for Apple state aid recovery

The Irish Department of Finance has confirmed that the London branch of Bank of New York Mellon has been selected as preferred tenderer for the provision of escrow agency and custodian services in connection with the Apple state aid recovery process.

A separate procurement process for investment managers for the recovery amount is currently in progress.

## People and firms

**BDO** appoints **David Britton** as partner to its London tax practice. Britton, formerly of EY, specialises in advising financial services companies on UK direct tax matters.

**Taxand**, the world's largest organisation of independent tax advisory firms, announces the addition of **Economic Laws Practice** as the new member firm for India.

*To publicise tax promotions, appointments and firm news, email paul.stainforth@lexisnexis.co.uk*

## Administration & appeals

### Finance Bill 2018 progress

The House of Lords debated the Finance Bill on 8 March and royal assent is expected on Thursday 15 March.

### ATED returns online

HMRC has confirmed that the current ATED online return forms will be withdrawn on 31 March 2018.

From 1 April, taxpayers will have to use the ATED online service to send a return for all years from 1 April 2015. Those unable to use the online service will need to contact HMRC to request a paper return. HMRC says it could take up to two weeks from request to deliver a paper return.

ATED returns for the year 1 April 2018 to 31 March 2019 should be submitted by 30 April 2018. This is also the deadline to pay the tax. If there is no tax to pay and other conditions are met, this is the deadline to submit a relief declaration return.

### Anti-money laundering guidance for the accountancy sector

HM Treasury has approved the new CCAB anti-money laundering guidance for the accountancy sector, updated for the 2017 regulations, which covers all entities providing audit, accountancy, tax advisory, insolvency, and trust and company services.

The Consultative Committee of Accounting Bodies (CCAB) has published new guidance for all entities providing audit, accountancy, tax advisory, insolvency or related services such as trust and company services, by way of business. (See the longer news item on taxjournal.com for more detail.)

Our pick

## *Conegate v HMRC*
## Claim for losses

In ***Conegate v HMRC*** [2018] UKFTT 82 (13 February), the First-tier Tribunal (FTT) found that losses claimed in relation to a repurchase of shares were not allowable.

Conegate was an investment company of which Mr Sullivan was the director and sole shareholder. Conegate (as well as Roldvale, a pension fund instituted for the benefit of Mr Sullivan) had entered into a subscription and shareholder agreement in respect of a company called WHH, which owned West Ham United Football Club. As a result, they owned 50% of WHH whilst the other 50% remained owned by CBH. Mr Sullivan started to look for ways of raising funds for the club. On the advice of his lawyers, Conegate implemented a set of transactions which involved the purchase of an additional 200 ordinary shares by Conegate and Roldvale. Those shares were converted into 200 deferred shares and then repurchased by WHH at a lower price.

Conegate appealed against HMRC's decision to refuse its claim for capital losses totalling £2m resulting from the disposal of the shares. Part of the substantive issue related to TCGA 1992 s 16A and Conegate's purpose in entering into the transaction.

The FTT had to decide, as a preliminary issue, whether legal privilege had been waived in relation to a series of emails between Conegate and its advisers. The FTT found that when Mr Sullivan (on behalf of Conegate) was referring to the advice the company had received, he was making the case that it was because of that advice that Conegate had taken the steps at issue. In the FTT's view, this was sufficient reliance or deployment to constitute waiver. As it was not practical to disclose the emails at this stage, the FTT drew an adverse inference from Conegate's failure to disclose them.

The main substantive issue was whether TCGA 1992 s 29 applied to the transaction. The FTT found that Conegate had exercised control of WHH and that value had passed out of the 100 ordinary shares it owned in WHH, when those had become deferred shares. This had therefore constituted a disposal of those shares by Conegate under s 29.

Furthermore, Conegate's disposal of the 100 ordinary shares was otherwise than by way of a bargain made at arm's length. It was not an agreement which would be reached if Conegate was acting solely in its own interests, and it was not 'the best deal Conegate could reach in the circumstances'.

Therefore, TCGA 1992 s 17(1) applied and the transaction was deemed to have taken place at market value. This meant that Conegate was deemed to have disposed of the shares for £2m. As it had also purchased the shares for £2m, it had not incurred a loss.

The FTT added that TCGA 1992 s 16A applied, as one of the main purposes of Conegate, when entering the transaction, had been the securing of a tax advantage. The loss would not have been allowable in any event.

Why it matters: **The FTT accepted that Conegate had entered into the transactions primarily because its director wished to provide additional funds to the football club it owned. This was the overarching aim of the transactions. However, there were additional and more complex reasons, including tax considerations. As a result, the losses claimed were not allowable.**

# VAT

## Bidding fees are not part of the consideration for auction goods

In ***Marcandi v HMRC*** (Case C-544/16) (7 March), the advocate general thought that fees paid to participate in penny auctions were paid for services which were separate from the goods purchased in the auctions.

Marcandi operates an online shopping business under the name 'Madbid'. Madbid sells mainly technology-related products, such as mobile telephones, tablets, computers and televisions. It provides an online platform where registered users can participate in online penny auctions to bid for, and win, goods. Users buy 'credits', which allow them to place bids. These cannot be used to purchase goods directly from the Madbid shop nor be converted back into cash.

The issue was whether the grant of the right to participate in a penny auction, in return for a bidding fee, is a supply of services subject to VAT, or a transaction, which is a preliminary step to the purchase of goods at the auction and therefore not subject to VAT.

In the opinion of the AG, the issue of the credits could not be regarded as a preliminary transaction to the purchase of goods, given that the credits could not be used as currency to purchase the goods. The AG also pointed out that the supply was the grant of the right to participate in an auction with the opportunity of purchasing goods below their market value and that there was no obligation on the winner of the auction to purchase the goods. Therefore, the issue of the credits did not necessarily lead to the purchase of the goods.

The AG added that the two supplies, of credits and of goods, did not form an indivisible economic supply as neither one was ancillary to the other. In particular, customers could chose to purchase goods directly. Finally, the AG thought that the fees paid for the goods were not payments on account.

Why it matters: **Whether VAT was payable on the bidding fees determined where the VAT was payable. If VAT was payable on the bidding fees, as suggested by the AG, it was due in the UK where Madbid is established. If VAT was due solely on the supply of goods, VAT would be due in the member state where the transport of the goods ended, in this case, Germany. The German authorities contended that this latter approach should prevail. It remains to be seen whether the CJEU will follow the opinion of the AG.**

## Was the sale of a building zero-rated?

In ***Cavendish Green v HMRC*** [2018] UKUT 66 (8 March), the Upper Tribunal (UT) found that the sale of a building did not fall within VATA 1994 Sch 8 Group 5 and was therefore standard-rated.

Cavendish Green had sold a development site in Surrey and the issue was whether the sale constituted a first grant by a person 'constructing a building designed as a dwelling, of a major interest in, or any part of, the building or its site' for the purpose of VATA 1994 Sch 8 Group 5 so that the supply was zero-rated.

There were two questions: first, whether Cavendish Green could be said to have been 'constructing a building designed as a dwelling' when, at the time of sale, the only part of the development which had been constructed was a garden wall; and second, whether planning consent had been granted (Group 5 note 2(d)).

The FTT had found that the garden wall was an integral part of the overall design, so that there was a building designed as a dwelling in the course of construction at the relevant date for the purpose of Group 5.

However, the FTT had also found that there was no express planning consent, so that the construction of the wall could only be a permitted Class A development under The Town and Country Planning (General Permitted Development) Order 1995 if it did not exceed two metres. The FTT had found that the wall exceeded two metres at the time of the sale and the UT was not prepared to admit fresh evidence to the contrary. The appeal must therefore fail.

**Why it matters: Cavendish Green sought to adduce fresh evidence that only the first part of the wall had been constructed at the time of the sale, so that it was less than two metres high. The UT accepted that the overriding objective of dealing with cases fairly and justly (Tribunal Procedure Rules r 2) included avoiding unnecessary formality; however, the admission of fresh evidence was not a matter of right but a matter upon which the UT should exercise a discretion. The UT found that Cavendish Green had 'ample opportunity' to adduce the evidence at the FTT, and it was therefore not prepared to admit it.**

## Administration & appeals

### Taxpayers' rights under the Liechtenstein disclosure facility

In ***City Shoes (Wholesale) and others v HMRC*** [2018] EWCA Civ 315 (2 March), the Court of Appeal dismissed an application for judicial review of HMRC's decision to restrict the advantages of the Liechtenstein disclosure facility (LDF) in relation to the claimants.

Although the LDF had originally been designed to counter the avoidance of UK tax by holding undeclared assets in Liechtenstein, it had become more widely used, with HMRC's consent, as a means of regularising UK tax liabilities for those with assets held anywhere offshore. The claimants were all advised by the same firm, BDO, and had applied for registration under the LDF between 30 August 2013 and 18 November 2013, in relation to employee benefit trust (EBT) arrangements they had implemented. Following an internal review, HMRC had informed the claimants that, because there had been an ongoing enquiry into their EBT arrangements at the time they had applied to be registered under the LDF, the favourable terms of the LDF resulting in a reduction of the amounts payable would not apply.

The claimants were seeking judicial review of HMRC's decision. Their application had been rejected by the High Court. The Court of Appeal accepted that it was 'regrettable' that HMRC had taken no steps to explain to BDO that the claimants' applications for registration would not be processed in the usual way while the review of the LDF was in progress. A formal public announcement of the commencement of the review would have been preferable to the relatively informal notification given to BDO and other agents. However, BDO and its taxpayer clients had been on notice that the LDF was under review and so they could not have expected their applications to be processed, regardless of the review.

The court also found that HMRC's ultimate decision had extended widely to embrace considerations of fairness in the interests of the general body of the taxpayers. The court therefore agreed with former HMRC commissioner Edward Troup's statement that 'it would not be unfair or improper, nor would it defeat any legitimate expectation, to refuse the claimants' applications to register for the favourable terms of the LDF.'

**Why it matters: Like the High Court, the Court of Appeal distinguished this case from *Hely-Hutchinson* [2015] EWHC 3261. In the present case, HMRC had provided a 'full and frank account' of its internal discussion leading up to the change of policy in 2014, which had itself resulted in the decision under challenge. In such circumstances, the claimants had not established a legitimate expectation.**

### Appeal struck out

In ***The First De Sales Limited Partnership and others v HMRC*** [2018] UKFTT 106 (28 February), the FTT struck out an appeal on the ground that the appellants had no reasonable prospect of succeeding in establishing that large payments to employees were deductible.

The appellants were partnerships and limited liability partnerships who had entered into arrangements disclosed under DOTAS. They had all made significant payments as contractual consideration for specific individuals granting restrictive undertakings and they claimed to be entitled to deductions in relation to these payments.

HMRC considered that the payments were not deductible and it submitted that there was no reasonable prospect of the appellants establishing that the payments were deductible. HMRC therefore applied to strike out the appellants' appeals.

HMRC contended that the appellants had provided little evidence (if any) to explain why such large payments, in respect of restrictive undertakings given by employees who performed largely administrative duties for relatively modest salaries, in connection with small business ventures, were commercially justified. The appellants argued that they had a reasonable prospect of establishing deductibility under ITTOIA 2005 s 69 or CTA 2009 s 69, regardless of the purpose of the payments. They contended that once a payment is within ITEPA 2003 s 225, it is automatically deductible under ITTOIA s 69 and CTA 2009 s 69.

The FTT observed, however, that the construction of tax statutes, as approached by the House of Lords in *Barclays Mercantile* [2004] UKHL 51, has two aspects: the construction of the statute; and the ascertainment of the facts. Contrary to what the appellants argued, this approach applied to both relieving provisions and taxing provisions, like s 225, as Parliament intended taxing statutes to 'operate in the real world'.

Finally, given the size of the payments (several hundred millions) and the modest salaries of their recipients, the FTT found that the appellants had not established the 'real world connection'.

**Why it matters: The appellants' attempt at restricting case law principles on tax avoidance to relieving provisions (as opposed to taxing provisions) was robustly rejected. And, in the absence of any evidence that the payments had been made 'in respect of' restrictive covenants, the FTT thought that it was likely that the payments had been made for tax avoidance purposes.**

## Case tracker update

New developments include:

- ***James H Donald (Darvel) Ltd and others v HMRC*** [2015] UKUT 514 (TCC) (employment taxes: can dividends be emoluments?): taxpayer withdrew appeal.
- ***Union Castle Mail Steamship Company Ltd v HMRC*** [2016] UKFTT 526 (TC) (corporation tax: derivatives): taxpayer appealed to UT. Hearing date: 6-8 Mar 2018. Hearing vacated.
- ***R (The Durham Company Ltd) v HMRC*** [2016] UKUT 417 (TCC) (application of PVD article 13 and VATA 1994 s 41A to local authority commercial waste collection services): Preliminary issues determined. Applied to UT for permission to appeal to the CA. Case management hearing scheduled for 25 April 2018.
- ***Cavendish Green v HMRC*** [2018] UKUT 66 (TCC) (whether building was 'designed as a dwelling' at the time of supply): UT dismissed the taxpayer's appeal.
- ***Scandico Ltd v HMRC*** [2017] UKUT 467 (TCC) (other evidence to justify input tax deductions where no invoice available): taxpayer applied to CA for permission to appeal.

See case tracker on taxjournal.com for a guide to the status of leading tax cases.

Cases reported by Cathya Djanogly (cathya.djanogly@hotmail.com)

## MTD for VAT: impossible, impractical or unduly onerous?

**The government has introduced the making tax digital for VAT legislation. But this is apparently without taking heed of the concerns of professional bodies, advisers or impacted businesses and before lessons can be learned from the pilot programme.**

In a mere 13 months' time, the UK's VAT-registered businesses will face major challenges in the accounting, recording and reporting of VAT.

Despite the uncertainty over the impact of Brexit, and how, when and even whether UK businesses will have to account for, report and pay import VAT and duty that is likely to be applicable on supplies from the EU, the UK is, nevertheless, implementing Making Tax Digital (MTD) for VAT-registered businesses from 1 April 2019.

Whilst MTD has been delayed for other taxes until at least 2020, the introduction of MTD for VAT will require all VAT-registered businesses with turnover above £85,000 per annum to submit their VAT returns digitally to HMRC - no more manual keying of return data into HMRC's portal.

Under MTD, businesses must keep certain mandatory records in a digital format within 'functional compatible software', able to interface with HMRC's systems, and thus send and receive information to and from HMRC. Taxpayers using multiple accounting software packages to record or calculate information that drives VAT return data must digitally link them to be MTD compliant.

The keeping of records in a digital format will therefore require businesses to have their sales broken down by the value of standard-rated, zero-rated, VAT exempt and outside the scope supplies. For those businesses which suffer a restriction in their VAT recovery, eg those involved in the finance, insurance, real estate, health, welfare and charitable sectors, there is the further complexity of identifying, on an invoice by invoice basis, the amount of VAT that can actually be recovered for each purchase invoice received.

Given the complexities involved, and the fact that businesses will need to have access to MTD compliant accounting packages, it was encouraging that HMRC published a consultation, and invited VAT-registered businesses to volunteer in a pilot to trial and test the MTD process before mandatory implementation.

However, some 18 days after the consultation closed, and before the MTD pilot has even begun, it is extremely disappointing that the government has introduced the MTD for VAT legislation, without apparently taking any heed of the concerns and observations aired by professional bodies, advisers or impacted businesses, and without the benefit of any feedback from the MTD pilot.

Adequate and appropriate legislation is crucial for the implementation of MTD. However, if all the complex issues which a significant number of VAT-registered businesses may face, particularly in a post-Brexit environment, have not yet been fully identified and adequately addressed, there must surely be serious concerns whether MTD should 'go live' in April 2019. ■

***David Wilson, RSM (RSM's Weekly Tax Brief)***

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## Terminal Markets Order: please terminate

**The European Commission launches infraction proceedings over the UK's VAT treatment of commodity derivatives.**

The European Commission notified the UK on 8 March 2018 of infraction proceedings against it in respect of the UK's VAT treatment of certain commodity derivatives transactions, alleging that the UK has not applied EU law and respected single market rules.

Currently, derivatives transactions on spots, futures and options on commodities contracts traded on certain exchanges are zero rated for VAT purposes in the UK. This includes commodities such as coffee, oil, wool and rubber, to the extent that the relevant derivatives are traded on specific named terminal markets, including the Intercontinental Exchange, London Metal Exchange, London Coffee Terminal Market, and London Grain Futures Market. Usually it is only necessary for one of the parties to the transaction to be a member of the relevant terminal market to attract the zero-rating, although slightly different rules apply depending on the type of transaction.

Where zero rating doesn't apply, the VAT treatment will generally follow the liability of the underlying commodity, although this is slightly different with options: the right to buy a commodity is a supply of services and is standard rated; exercise of the option is a supply of the commodity itself and will follow the liability of the commodity.

The UK rules on zero rating of these transactions are contained in the Terminal Markets Order 1973 and have been permitted by derogation by the EU since 1977 under article 394 of the VAT Directive as a permitted special measure and a type of 'standstill' derogation. Article 394 allows member states to simplify rules for collecting VAT, provided there is only negligible effect on VAT revenue overall.

As such, the UK is not permitted to extend the original scope of the derogation. The Commission is alleging that the UK has done just that, not because the UK has changed the wording of the derogation (it hasn't, aside from amendment orders, mostly altering the specified terminal markets), but because the UK has allowed increasingly complex types of instruments, traded on increasingly complex markets, to fall within the derogation, with the consequence that the derogation is now no longer limited to trading in the commodities and as such is not being applied correctly. In the Commission's view, it seems, the 'standstill' agreement from 1977 is no longer fit for purpose.

The Commission argues that the UK's commodity derivatives transactions zero rating creates 'major distortions of competition to the detriment of other financial markets within the EU'. There have reportedly been a number of informal complaints from other member states that London's commodity markets have an unfair advantage. Grouchiness that the home of two of the EU's largest commodities exchanges is (a) permitted a competitively advantageous VAT zero rating and (b) leaving the EU is perhaps unsurprising.

Grouchiness that the home of two of the EU's largest commodities exchanges is (a) permitted a competitively advantageous VAT zero rating and (b) leaving the EU is perhaps unsurprising

The Commission's letter (pursuant to article 258 of the TFEU) is the first stage of infraction proceedings, a process which ultimately allows the Commission to refer the case to CJEU. At this stage, the UK is invited to respond within two months and present its views regarding the breach the Commission has alleged. The UK government's statement (see bit.ly/2GhmFm5) gives little insight on its position, merely stating that it will respond in 'due course'.

If the UK's response is considered 'insufficient', the Commission will then issue a 'reasoned opinion', before referring to the CJEU.

In infraction proceedings, the UK has a strong track record both in terms of resolving cases without the need for CJEU involvement, and in terms of winning cases that have reached the court. The question as to whether the UK government will agree that the Commission is entitled to continue proceedings after Brexit remains an open one. Infringement proceedings often take over three years to be settled, and the UK is set to leave the EU on 29 March 2019, in little over a year's time. It remains to be seen whether this will impact on the government's approach to these proceedings. For now, the UK remains subject to EU law and the Commission remains within its right to commence proceedings.

Discussion about Brexit and VAT has tended to focus on import VAT and the impact on 'frictionless' trade on the Irish borders and at English Channel ports. But with last week's European Council guidelines (see bit.ly/2I8bhK0) on the future relationship between the UK and EU specifically mentioning the prevention of 'unfair competitive advantage that the UK could enjoy through undercutting of current levels of protection with respect to [inter alia] tax', the UK will need to negotiate hard to prevent it being fettered in its ability to design its VAT system after Brexit. ■

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## Dutch withholding tax

### A glimpse of the future?

**The past:** The Dutch aren't big on withholding taxes (WHTs), even less than the UK. There's no WHT on royalties and WHT on interest is limited to loans that work like equity (so the interest is a proxy for dividends). However, unlike the UK there is WHT on dividends. The Dutch dividend WHT is set at 15% which is reduced or eliminated by an applicable double tax treaty or the Parent Subsidiary Directive.

**The present:** From 1 January 2018 the Dutch have provisionally altered their WHT rules. On the one hand they have extended WHT to dividends paid by Dutch holding cooperatives (70% or more of their activity is holding connected entities or providing financing to them) to bring them into line with Dutch holding companies, but on the other hand they have extended the WHT exemption to qualifying shareholdings in non-EU companies.

The way the extension is being introduced is in line with the implementation of the OECD BEPS report 6 on stopping abuse of tax treaties. The new Dutch provision does this by applying two tests. The first is whether the company receiving the dividend is holding the Dutch shares in order to take advantage of the WHT exemption. A company will pass this test if it is resident in the EU/EEA (possibly relevant to the UK), or a territory with which the Netherlands has a double taxation treaty.

The second test is passed if the recipient is a company based outside the Netherlands that acts as a link between the paying company and the top holding company (i.e. an intermediate holding company) – and it has sufficient substance. This means it must:

- incur employment costs of at least €100,000 in respect of its holding company functions;
- have its own office space for 24 months to carry out its duties as an intermediate holding company;
- at least 50% of its managers must be resident in the territory where the intermediate company is located;
- the managers must be sufficiently experienced to carry out their duties;
- other personnel within the company are also sufficiently experienced to carry out their duties, and there are enough of them to do so;
- Board decisions of the company are taken in the territory where it is resident;
- the intermediate holding company's bank accounts are in its territory of residence;
- the intermediate holding company keeps its accounting function in its territory of residence.

Clearly the aim is to put 'brass plates' to bed and avoid the claim that the Netherlands is a tax haven and/or facilitating abusive practices.

> The Dutch clearly have one eye on the UK. The abolition of the dividend WHT will remove one of the advantages the UK has as a company location over the Netherlands

**The future:** The coalition agreement for the new Dutch government proposes that, apart from the sort of anti-avoidance rule mentioned above, WHT on dividends will be abolished by 2020. Whilst the above changes are in force as of 1 January 2018, they are only provisional and subject to the final agreement of the Dutch Parliament.

In addition, it is also likely that a royalty WHT will be introduced in due course. Although no proposals have been put forward yet, a safe bet would be something very similar to the anti-avoidance dividend WHT rule already outlined.

As an aside, the Dutch, being competitive creatures, clearly have one eye on the UK. The abolition of the dividend WHT will remove one of the advantages the UK has as a company location over the Netherlands (we wonder whether this is aimed at trying to persuade Unilever to become a wholly Dutch company after Brexit!). Furthermore, the coalition agreement signals a reduction in Dutch corporate income tax to 21% by 2021. Another challenge to the UK? ■

***Miles Dean, Milestone International Tax Partners (miles@milestonetax.com)***

## EBTs and the new 'outstanding loan' charge

### The new 'outstanding loan' charge applies in April 2019. What if the individual dies in the meantime?

The standard of legislative drafting in the UK is very high and particularly so in the case of tax legislation. It was therefore a surprise to have discovered an error in the highly complex 'disguised remuneration' rules first enacted in 2010, and since amended on many occasions, most recently in the F(No. 2)A 2017 to take account of the forthcoming 'outstanding loans' charge in April 2019, and which the Parliamentary draftsman has accepted will need to be corrected in a future Finance Act.

The sub-section in question is s 554A(4) of ITEPA 2003. As most recently amended, this is intended to provide that the 2019 'outstanding loan' charge will not apply if the individual who has received the loan from an EBT (or other relevant third party) has then died. It appears that the draftsman (perhaps understandably) overlooked the fact that the sub-section had already been amended by the first Finance Act of 2017. As a result, the words: '…or a relevant step within para 1 of Sch 11 to F(No. 2) A 2017 which is treated as being taken…' [i.e. the 2019 outstanding loan charge] have ended up in the wrong place. As it stands, s 554A(4) can be of no effect, as neither of the conditions in sub-paras (a) or (b) [i.e. that the relevant step is within s554B or 554C] will ever be satisfied in the case of such an 'outstanding loan charge'.

To give effect to the presumed intention, s 554(4) should read:

'Chapter 4 does not apply by reason of a relevant step taken on or after A's death if:

'(a) the relevant step is within s 554B, or

'(b) the relevant step is within s 554C by virtue of subsection (1)(ab) of that section, or

'(c) it is a relevant step within para 1 of Schedule 11 to F(No. 2) A 2017.' ■

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Spring Statement 2018

# The big picture

## Forward with a spring?

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Philip Hammond's quiet revolution isn't just quiet, it's slow. Although he called time on the hurly-burly of a two-fiscal-event year in November 2016, we still haven't seen a full cycle of the new process. However, the delivery of the Spring Statement sees another element of the Hammond architecture fall into place.

### So what are we to make of this first Spring Statement?

For starters, we need to judge it in terms of what the Spring Statement is intended to achieve: it has a particular role to play in Hammond's new approach, and should not be viewed just as a time-shifted Autumn Statement.

In prosaic constitutional terms, the Spring Statement delivers the chancellor's statutory obligation to publish an economic forecast twice a year. That was also the function of the Autumn Statement, and its predecessor the Pre-Budget Report, but over the years those versions had morphed into fully-fledged 'mini-budgets', replete with tax policy changes and spending decisions. In the build-up to this statement, the chancellor stressed that he would not fall prey to temptation and announce policy decisions, but merely inform and consult.

But this new non-fiscal event is more than just an economic update, as detailed in the Treasury's new tax policy making model, set out just before Christmas. This confirmed that the Statement would also be an opportunity to raise items for early consideration, before more definitive consultation documents were launched at the Autumn Budget.

In the event, the Statement has pretty much stuck to this intention, launching over a dozen new consultations.

### What do the consultations tell us about the direction of government thinking?

Firstly there is a real focus on digital, with a range of consultations (and calls for evidence) focused on different aspects of the digital challenge.

At the policy level, the Treasury has updated its position paper on *Corporation tax and the digital economy*, first issued following the November Budget. In a context where the European Commission and the OECD are racing to air their ideas on the future taxation of digital, Hammond has taken this opportunity to refurbish the UK's stall in the light of input received since the November Budget. This reinforces the UK's position in this global debate and deepens the discussion on issues such as how to identify and measure user-created value, and how international tax rules might be adapted to the new environment.

The Spring Statement also launches a number of consultations designed to bolster the administration of tax in the area of digital. These include:

- the role of online platforms in ensuring tax compliance by their users;
- cash and digital payment in the new economy; and
- a split payments system, which would allow VAT to be extracted from online payments in real time.

Secondly, we have a significant discussion to come about the level of the VAT registration threshold. Having for some time made a virtue of the fact that the UK's VAT threshold is the highest in the EU (thereby sheltering smaller businesses from the burden of VAT administration), the government now wants to examine the other side of the coin: does a high threshold act as a blocker to growth?

Finally – and particularly for those with an interest in the development of the Treasury's policy approaches – we saw a call for evidence on single-use plastic waste. Prior to the arrival of George Osborne, the 'Treasury view' had always been against any form of hypothecation. But Tuesday saw Hammond committing (at least 'some' of) as yet unraised (indeed, even yet to be designed) taxes to fund green products and processes. An interesting precedent for those with a spending priority to fund!

### So he broke the chancellorial mould, and resisted the lure of announcements?

Well, not entirely. On the ever-sensitive issue of business rates, Hammond could not resist announcing in another consultation document that he will bring forward, by one year, the next business rates revaluation to 2021, and have triennial reviews thereafter. But, back on the theme of the future, the consultation document does note that the government is reviewing the wider taxation of the digital economy, before raising the prospect of 'considering the implications for the wider business tax system to ensure all businesses make a fair contribution to the public finances'.

Also, in the case of heated tobacco products, he took the opportunity to report on the outcome of his earlier consultation. On one level, that might be considered bad form (an outcome cuckoo in the consultation nest). On another level, though, it can be seen as an example of good practice, with the final outcome showing clear signs of having been shaped by the expert input of stakeholders from both the tobacco industry and the public health field.

### What happens next?

With these new consultation documents launched, a few more to follow and a new consultation tracker to help us manage, we now enter the active discussion phase. This should provide the Treasury with the stakeholder input it needs to develop the proposals which will emerge at the Autumn Budget. At that point, we get back into the world of announcements, changes, winners and losers. All the fun of the policy fair! ■

Spring Statement 2018

# Corporate tax and the digital economy

**Lots of questions – but no simple solutions.**

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The concept of a permanent establishment worked well in the days when a physical presence was needed in order to sell goods. With the increasing growth of digital business transactions, the role of the 'sales rep' has almost disappeared, and governments across the world struggle with how to extract their 'fair share' of taxation.

This paper updates the one published at November 2017, and continues to explore the concept of 'user value'. There is a recognition that simply taxing businesses by reference to sales would have unforeseen consequences, particularly as more and more sales are made over the internet. Hence it is agreed that mere sales do not create value, but that in some cases the users themselves contribute significantly to the enterprise's value chain. The challenge is how to recognise, and then tax, that value.

User-created value is considered to arise in a number of situations. Four channels are identified:

- User-generated content, for example an online platform which generates revenue from selling advertising on a platform populated by users' posts and photos;
- Users who form strong relationships with an online platform, so that the business can generate valuable data through monitoring of users' engagement;
- Building a large user network, so that the value a user derives is enhanced by the number of other active users; and
- Contributing to brand strength and reputation, for example through user participation in reviewing and rating services.

The long term solution is far from simple, and the paper recognises that achieving consensus will be difficult (for which, read impossible in the next few years?). For many years, OECD transfer pricing principles have allocated value by reference to functions, assets and risks: the proposal is that a new element should be added, in respect of user value. This would mean updating the OECD model convention in respect of articles 5 (permanent establishment), 7 (taxing business profits attributable to a permanent establishment) and 9 (profits should be commensurate with value generated). Crucially, the end result would be that some of the profit currently considered to be entrepreneurial profit would be reallocated to the location of users. It is recognised that any long term solution would need international agreement, probably via the OECD. The obvious difficulty with this is that the US, in particular, is likely to object strongly to its taxing rights being reduced.

The paper therefore also outlines a potential interim solution, which is aligned with the EU's proposals for a tax on revenues. The government would prefer a multilateral solution, but makes clear that it will press ahead with a sub-group of like-minded countries, or alone if necessary.

The aim of a revenue-based tax would be to 'raise revenue from digital businesses that are deriving material value from user participation'. This poses a number of challenges, in identifying the appropriate businesses, ensuring the tax can be applied effectively (particularly where groups have multiple business lines) and recognising that groups will have varying levels of profitability. In determining the scope of the tax, three legislative approaches have been identified:

- Define the channels through which users create value, and then impose a tax on revenue streams of businesses for whom those channels are 'most relevant';
- Objectively define the categories of businesses that derive most value from user participation, and then impose a tax on those businesses. For example, this might involve defining social media platforms, search engines and online marketplaces; or
- Define the revenue streams that are commonly generated from those businesses, and then charge the business in relation to such revenues. This might mean a tax on revenues from online advertising or revenues from facilitating third-party transactions on an online platform.

None of these approaches is likely to be simple, and a key risk will be that as soon as a definition is agreed, business models will change so that new businesses will no longer be within scope. The sheer speed of development in this area makes it unlikely that a stable tax base could be identified. Whichever approach is used, there is likely to be a high *de minimis* threshold, in order to protect start-ups and smaller businesses.

It will also be necessary to identify which revenues should be subject to charge in the UK, and this will involve identifying UK users. Whilst there are some practical difficulties (such as users who are travelling, or using a virtual private network), the document notes that similar challenges have been overcome for VAT. This does, however, beg the question of why a revenue-based corporate tax, rather than VAT, is considered to be the best way to tax these digital businesses? The EU Group of Experts on the Digital Economy, which reported in 2014, addressed similar issues and recommended a greater focus on VAT, or possibly a destination-based corporate tax.

Finally, it should be noted that the updated paper does not address the proposed withholding tax on royalties. This was the subject of a separate consultation which closed on 23 February 2018, and it appears it will be introduced as planned in April 2019.

The position paper invites comments, but without setting a specific deadline. Whatever the ultimate answer, it seems likely that it will do nothing to reduce the complexity of the UK tax system, and perhaps the main aim of this paper is for the chancellor to be seen to be at least thinking about 'doing something' in relation to the taxation of digital businesses. ■

**For related reading visit www.taxjournal.com**

- Taxation of the digital economy: unilateral measures (B Jones, S Seabrook, S Sciliberto & G Jones, 1.3.18)
- The royalties withholding tax consultation: non-UK UK source (J Cape & B Gilbey, 17.1.18)

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# Enforcement and compliance aspects

**The documents issued alongside the Spring Statement had a particular focus on the 'new' economy.**

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The chancellor of the exchequer was true to his word that the most we should expect from the Spring Statement was announcements of consultations and calls for evidence. In the event, the papers issued by HMRC and Treasury had a particular focus on the 'new' economy. They include a paper on online platforms focusing on educating users about direct tax compliance, a consultation on a 'split payment' measure to counter VAT fraud by overseas sellers and a document looking at the use of cash.

## User compliance: online platforms

First, there was a 'call for evidence' on how online platforms can help to ensure user tax compliance. The document notes the efforts already made by platforms to help with VAT compliance, in part voluntarily and in part in response to new legislation. This call for evidence focuses more on direct tax; and in particular on the growth in 'amateur' (my expression) trading.

The paper is generally focused on what platforms can do to educate users. When looking at what other countries do, however, there is a reference to one country requiring the platform to deduct income tax at source, which may develop as an idea by the time the call for evidence becomes a full-blown consultation.

The paper also highlights a practical difficulty HMRC has in using its 'bulk data' powers to gather information from platforms where the data is held offshore and outside the reach of HRMC's powers. It is not clear how HMRC expects to tackle that issue.

## Revenue-based digital tax

The updated position paper, *Corporate tax and the digital economy*, is of course focused on taxing the profits made by companies providing the digital economy infrastructure. It also notes the practical difficulties HMRC would have in administering a revenue-based tax, given that many of the entities in scope will be outside the UK altogether. Whilst the paper makes it clear that HMRC stands ready to act on its own if necessary, the paper shows the difficulties any fiscal authority has with applying tax to digital companies which bestride jurisdictional boundaries. That said, HMRC interestingly points to its experience in applying VAT to overseas sellers as a reason not to have too many concerns.

## VAT split payment

While on that subject, following publication in December of a summary of responses to its earlier call for evidence, HMRC has now published a formal consultation on options for a 'split payment' measure to counter VAT fraud by overseas sellers.

One of the design principles involves working out who in the payment chain is best placed to siphon off the VAT element of a transaction and pass this straight to HMRC.

In relation to transactions involving overseas sellers generally, HMRC has concluded that the 'merchant acquirer' – which 'acquires' the debt from the retailer at the point of sale and passes it on to the company that issues the payment card to the customer – is best placed to apply the split. Recognising that the acquirer may be outside the UK, the consultation suggests that the card issuer (typically UK based) will be required to operate the split itself; unless, for each transaction, the card issuer is able to find the acquirer on a live register of trusted acquirers kept by HMRC. In relation to transactions through an online marketplace, unsurprisingly the consultation suggests that the platform itself is best placed to operate the split.

The consultation also considers options for how much money should be withheld:

- Option 1 is the blunt approach. This involves assuming that 20% VAT applies and leaving it to the online seller to deal subsequently with HMRC to claim back any overpayment and deduct any allowable input tax.
- Option 2 involves a form of flat rate scheme.
- Option 3 involves the seller using past performance to calculate its likely 'effective' VAT rate (with option 1 being applied if it doesn't do so). This option is HMRC's preference.

## Cash and the hidden economy

A call for evidence on cash and digital payments in the new economy highlights the decline in use of cash but the importance of keeping it open as an option for payment, with research showing that 2.7m people are entirely dependent on it. The paper made the news because it proposed the abolition of one and two penny coins, 8% of which are apparently thrown away. It also notes the paradox that whilst digital transactions should help to ensure a reduction in the 'hidden economy', the effect is not that great because as long as there is cash there will continue to be a safe place for evasion (although presumably as the tide goes out, it will be easier to find the non-compliant traders and consumers). The call for evidence focuses in particular on why cash is still used for large transactions – the subtext being that there must be something implicitly dodgy about using wads of cash rather than a simple electronic payment.

## Security for payment

Finally, building on a prior call for evidence, HMRC has started a consultation on extending security for unpaid tax regimes to corporation tax and the construction industry scheme. Such security regimes are a 'downstream' response to previous non-compliance, but the consultation also highlights a separate paper (not yet published) on *Tax abuse and insolvency* and how individuals use limited liability to evade liability or avoid payment. More is expected on this soon.

All in all, whilst the Statement did not include many new enforcement measures, it did show the increasing trend towards HMRC using large businesses to be HMRC's unpaid tax inspectors. ■

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# Economics review

**The chancellor bides his time as the UK remains in the slow lane of global growth.**

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UK economic growth has slowed over the past couple of years, but the latest news has been somewhat more positive on the back of a stronger global economy. The Office for Budget Responsibility (OBR) nudged up its 2018 GDP growth forecast from 1.4% to 1.5% to reflect this better international outlook.

Looking further ahead, however, the OBR has not made any material changes to its growth projections, sticking to the downward revisions to productivity growth it made in its November forecasts. As a result, average UK growth is still expected to be only 1.4% over the next five years, well below its long-term historical average of just over 2% per annum. The OBR expects the UK to remain in the slow lane of global growth for some years to come.

The OBR has also kept its inflation projections largely unchanged, still expecting this to fall from around 3% now back down to its 2% target rate over the next year. This will allow real wage growth to edge back into positive territory later this year, though it will remain modest by historical standards.

The OBR also revised down its public borrowing estimate for 2017/18 from around £50bn to only around £45bn given better than expected public finance data so far this year. This downward revision was a bit less than expected, however, largely because the OBR is doubtful that hard-pressed local authorities will underspend their budgets by as much as the Office for National Statistics (ONS) is assuming.

This relatively modest public borrowing undershoot is expected to persist into future years, with borrowing in 2020/21 now expected to be around £4bn less than in November. This improvement, however, is judged by the OBR to be largely cyclical, rather than reflecting an underlying structural improvement in the public finances.

Relative to the chancellor's target of getting the structural budget deficit below 2% of GDP in 2020/21, the comfort margin has therefore remained largely unchanged since November at just over £15bn. At around 0.7% of GDP, this is well within the margin of error for any borrowing forecasts looking three years ahead, so there is no room for complacency about hitting this target.

In these circumstances, it was not surprising that the chancellor chose to bide his time for now, with no significant tax or spending changes in the Spring Statement. However, with increasing strains being evident on public services such as the NHS and social care, the chancellor will be under considerable political pressure to ease off on austerity in his Autumn Budget.

> Average UK growth is still expected to be only 1.4% over the next five years, well below its long-term historical average of just over 2% per annum

The chancellor remains concerned, however, that the public debt to GDP ratio is still uncomfortably high at around 85% of GDP. He argued again in his Spring Statement that this needs to be brought down over the next five years to put the public finances in better shape to cope with any future economic shocks. This is in line with George Osborne's old dictum of 'fixing the roof while the sun is shining'.

There is certainly some merit in this view, particularly at a time when the outcome of the Brexit negotiations remains uncertain. By November, however, some of these uncertainties will hopefully have been resolved and, if the economy has continued to perform reasonably well, the chancellor may feel able to direct some extra resources to priority areas. But we would not expect a major shift in the stance on fiscal policy in the autumn. ■

**Comparison of key OBR forecasts in March 2018 and November 2017**

| **Real GDP growth (%)** | **2017** | **2018** | **2019** | **2020** | **2021** | **2022** |
|---|---|---|---|---|---|---|
| Spring Statement (March 2018) | 1.7 | 1.5 | 1.3 | 1.3 | 1.4 | 1.5 |
| Budget (Nov 2017) | 1.5 | 1.4 | 1.3 | 1.3 | 1.5 | 1.6 |
| **CPI inflation (%)** | | | | | | |
| Spring Statement (March 2018) | 2.7 | 2.4 | 1.8 | 1.9 | 2.0 | 2.0 |
| Budget (Nov 2017) | 2.7 | 2.4 | 1.9 | 2.0 | 2.0 | 2.0 |
| **Public sector net borrowing (£bn)*** | **2017/18** | **2018/19** | **2019/20** | **2020/21** | **2021/22** | **2022/23** |
| Spring Statement (March 2018) | 45 | 37 | 34 | 29 | 26 | 21 |
| Budget (Nov 2017) | 50 | 40 | 35 | 33 | 30 | 26 |

*Excluding borrowing of public sector banks.
*Source: OBR*

Spring Statement 2018

# The tax measures

A summary of the tax-related consultations, and other tax developments, published at the Spring Statement, by Lexis®PSL Tax.

## Headlines

Documents published alongside the Spring Statement include:

- an updated position paper setting out the government's view on preferred solutions to challenges posed by the digital economy on the corporate tax system;
- a consultation on creating a fund structure within the enterprise investment scheme for investment in innovative knowledge-intensive companies;
- a consultation on changes to entrepreneurs' relief to avoid discouraging entrepreneurs from seeking external finance for their companies;
- a consultation on extending the existing securities regime to corporation tax and construction industry scheme deduction;
- a call for evidence on the VAT registration threshold;
- a consultation on the role of online platforms in ensuring tax compliance by their users;
- a consultation on the design of a split payment mechanism for online sales;
- a call for evidence on the role of cash and digital payments in the new economy; and
- a consultation on the extension of tax relief for training by employees and the self-employed to support upskilling and retraining.

The Chancellor of the Exchequer, Philip Hammond, delivered his first Spring Statement on Tuesday 13 March 2018. Sticking to his promise of a single fiscal event each autumn, Hammond did not announce any new spending commitments or immediate tax changes, instead stating that the abolition of twice-annual tax changes gives businesses more certainty and aligns the UK system with those of its counterparts.

As promised, the chancellor's statement focused on providing an update on the overall health of the economy and a summary of the public finances provided by the government's independent forecaster, the Office for Budget Responsibility (OBR).

The Spring Statement was used to announce policy reviews and consultations. Immediately following the Spring Statement, the Treasury published 13 consultation documents inviting views on future changes to the tax system.

### Corporate tax and the digital economy: position paper

Following the publication of a position paper at Autumn Budget 2017 and a consultation that ran until 31 January 2018, the government has published an updated position paper reflecting feedback from stakeholders and providing more details. This is not a final paper and has been published with a view to further engagement to resolve outstanding questions.

As before, the government recognises that many online digital businesses rely on their users to generate revenue and create value through their active participation in the platform. The updated paper provides a more detailed explanation of how the government thinks this value is created. Examples include the advertising revenue that is generated by a social media platform as a result of users uploading their own content, and where sustained engagement by users allows a business to tailor its platform and content to each specific user. The updated paper differentiates between users and customers, with users performing supply-side functions which a business would otherwise have undertaken. The paper also sets out the government's view that data collection is not equivalent to user participation and thus the sourcing of data from the UK should not entitle the UK to a taxing right on any business profit.

In the government's view, user participation is most relevant for online networks such as social media platforms, file or content sharing platforms, search engines and online marketplaces, and less relevant for businesses such as e-retailers and digital software/hardware providers. The government recognises there is a need to continue to examine business models to make sure any tax measure is correctly targeted and can distinguish between different business categories. Newer business models, e.g. those based on artificial intelligence or augmented reality, also need to be considered.

As stated in the previous position paper, the government believes that the best way to capture 'user-created value' is to reform the international corporate tax framework to reflect the value of user participation. The framework would need to be amended to set out a method for determining user-created value and to identify the companies which should be taxed on profits attributable to that value. Jurisdictions would then need to be given the right to tax those companies and a method would need to be agreed for allocating user-created profits between each jurisdiction with a taxing right. This would require modifications to articles 5, 7 and 9 of the OECD Model Tax Convention and to the OECD transfer pricing and profit attribution guidelines. The updated position paper includes a possible approach (together with practical examples), setting out the government view that:

- It is likely that the value from user participation is realised in the companies in a group which receives the residual profits of the business after the service providers have received an arm's length return, so a reallocation of the profits of these residual profit owners (also referred to as 'principal companies' in the paper) is justified and achievable.
- The inherent difficulty in measuring user-created value means it might be necessary to reward that value through a percentage share of the residual profit realised by the principal companies in the group, designed to approximate the value that users generate. The government suggests that OECD guidance could include parameters for the share of residual profit that can be allocated to user participation for different categories of business, together with an approach for deciding where a particular business should be placed within those parameters based on business-specific criteria.
- When determining how the user-created value should be allocated between different user jurisdictions, an allocation key could be used to approximate the value of users in each jurisdiction. Rather than relying on

user numbers in each jurisdiction, the allocation key would need to account for variations in user value which could mean looking at 'active users' or revenues attributable to users in each jurisdiction.

- The simplest approach when considering which legal person to tax would be to allow jurisdictions to tax the principal companies in proportion to the participation of local users. Challenges thrown up by this are discussed further in the paper.
- The amount of business profits that can be taxed by user jurisdictions should be limited to ensure sufficient recognition of value derived from elsewhere. There should also be a threshold which would need to be satisfied before a jurisdiction would have a right to tax a share of user-created profits, i.e. a permanent establishment threshold set at a higher level than just the presence of local users.

Although the ideal solution is a multilateral one, the government has reiterated that it intends to look at interim options to raise revenue from digital businesses which generate value from UK users and that it is prepared to act unilaterally. It envisages a tax on the revenues of digital businesses deriving significant value from UK user participation, irrespective of the physical presence those businesses have in the UK. The updated paper discusses considerations regarding the scope and design of such a measure.

The government intends to engage further on the scope of the interim tax measure. It commented that the tax could apply to: businesses for which the channels through which users create value are most relevant; specific business types; or specific revenue streams of any type of business. It is likely the government will only tax revenues which relate to users in the UK but it is aware that there are challenges in identifying user location. The paper also includes suggestions to ensure there are protections built in for start-ups and growth companies.

The government intends to keep engaging with businesses, the OECD's Inclusive Framework and the EU in order to develop an effective policy solution. Stakeholders can provide written feedback on the updated policy paper, albeit there is no deadline for submission.

See *Corporate tax and the digital economy: position paper*, available via bit.ly/2iH1EH3.

## EIS knowledge-intensive fund consultation

As announced at Autumn Budget 2017, the government is consulting on creating a fund structure within the enterprise investment scheme (EIS) for investment in innovative knowledge-intensive companies (KICs) that would enable the use of capital over a long period. These proposals form part of the government's response to the patient capital review (conducted in 2017).

The patient capital review identified that KICs, meaning companies that are R&D-intensive and capital-intensive and have high growth potential, have the most difficulty obtaining the capital they need to grow. As a result, a number of changes are being made in Finance Bill 2018 ('FB 2018', i.e. the Finance (No. 2) Bill 2017–2019, published on 1 December 2017 and which will be enacted as Finance Act 2018) to loosen the conditions for EIS and venture capital trust reliefs for investments into KICs. This consultation is considering solutions to close that gap further.

The consultation considers two broad areas:

- the capital gap for KICs and how a new KIC EIS fund might help to address it; and
- the features of the proposed KIC EIS fund.

### Capital gap for KICs

On the capital gap, the government is asking:

- why some KICs are unable to obtain the patient capital they need;
- what the best way of improving it would be, within the constraints of state aid; and
- what barriers there currently are to the establishment of investment funds focused on KICs.

### KIC EIS fund structure proposals

The government identifies that there is a limited approach to EIS funds in the existing legislation, broadly enabling investors through a fund to be treated as if they had made the EIS investments themselves; and an accompanying option for the fund manager to seek HMRC approval to reduce the administrative burden. However, HMRC state that very few funds seek HMRC approval. To reduce complexity, any new fund structure would replace the existing fund arrangements.

The government's approach to the new EIS fund is:

- all fund managers would need to seek HMRC approval;
- substantially all investments made by the fund would have to be into KICs, with a possible 10% to 20% allowance for non-KIC investment; and
- investments through the new structure would still have to be equity investments.

The options the government is considering to incentivise investment into knowledge-intensive funds are:

- a patient dividend exemption: giving investors an exemption from tax on dividends received from knowledge-intensive investee companies after a fixed holding period (with five or seven years being suggested);
- capital gains relief: giving investors the opportunity to write off a proportion of their capital gains when they roll over investments into a KIC fund. A specific proportion is not proposed, but it is stated to be less than the current deferral relief for seed enterprise investment scheme investments, which is 50%;
- extended carry back: allowing investors into KIC funds to carry back their investments, for the purposes of both income tax and capital gains deferral relief, further than the standard one year; and
- upfront tax relief: enabling investors to get tax relief when they invest into the fund (rather than when the fund invests into an underlying KIC), provided the fund commits the funds within a specified time period (with two years being suggested).

The government confirms that:

- the new fund structure will use the existing definition of a KIC;
- it is not considering changing the rates of tax relief;
- the new structure will not involve all of the tax incentives outlined above, only the most effective and targeted incentives;
- the new structure will need to be robust to prevent its use for aggressive tax planning or capital preservation; and
- any changes implemented before the UK leaves the EU will need state aid approval.

The consultation is open until 5 May 2018.

The government has stated in its new consultation status tracker (bit.ly/2GpLtIP) that these changes are intended to be legislated in Finance Bill 2019 ('FB 2019', i.e. Finance (No. 3) Bill 2017–19, which will be enacted as Finance Act 2019). We might therefore expect to see draft legislation published this summer.

See *Financing growth in innovative firms: Enterprise investment scheme knowledge-intensive fund consultation*, available via bit.ly/2pb4Ugm.

### Entrepreneurs' relief on gains made before dilution

Following its review of the environment for business growth in the UK and as announced at Autumn Budget 2017, the government is consulting on extending entrepreneurs' relief so that individuals can continue to access the CGT relief where their shareholdings are diluted below the qualifying 5% level as a result of raising finance.

Entrepreneurs' relief provides a lower 10% rate of CGT for gains on qualifying disposals of business assets, which include certain disposals of shares in a company by an individual where that individual has held at least 5% of the ordinary share capital prior to the disposal. Currently, the 10% CGT rate may be lost where the entrepreneur's company issues new shares to raise capital and, as a result of not purchasing further shares themselves, the entrepreneur's personal stake falls below 5%.

The consultation paper explains that there have been concerns that the 5% minimum shareholding requirement for entrepreneurs' relief can act as a barrier to growth for some businesses. It can disincentivise entrepreneurs from seeking external investment and can encourage individuals to exit their businesses early, so as not to lose the benefit of the relief. This outcome conflicts with the relief's intended purpose, which is to encourage enterprise.

The paper sets out some details on how entrepreneurs' relief is proposed to be extended and invites views on how this will work in practice. Specifically, it makes the following proposals:

- Individuals will be allowed to elect to be treated as having disposed of, and reacquired, their shares immediately before their shareholding is diluted as a result of external fundraising at their then-market value. (This will enable the individual to crystallise a gain, and thereby their entitlement to entrepreneurs' relief, at a time when their shareholding is still at or above the 5% level.)
- In order to avoid a 'dry' tax charge arising at the time of an election, individuals will be allowed to defer the accrual of the gain (and thereby the tax charge) on the deemed disposal until any of the 'rebased' shares are actually disposed of.

To ensure that the relief is properly targeted, the dilution of the individual's shareholding must be a consequence of an issue of new shares made by the company for genuine commercial reasons. The consultation paper also touches on the interaction of the changes with the share pooling rules and rules for trusts, and sets out some detail on the precise time at which a deemed disposal would take place.

The amending legislation is proposed for FB 2019 and will apply in respect of fundraising events taking place on or after 6 April 2019. Comments on the consultation should be submitted by 15 May 2018 and the government will publish its response and draft legislation in summer 2018.

See *Consultation: Allowing entrepreneurs' relief on gains made before dilution*, available via bit.ly/2FGpEDH.

### Extension of security deposit legislation

As announced at Autumn Budget 2017, legislation will be introduced in FB 2019 to extend the scope of the existing security deposits legislation to include corporation tax (CT) and construction industry scheme (CIS) deductions, with effect from April 2019. The government has published a consultation which invites comment on proposals for implementing these changes.

HMRC currently has powers to require a security deposit in respect of certain taxes and duties, including VAT, PAYE and NICs. The legislative provisions of the security regime vary slightly to reflect the design of the individual tax or duty, but in all cases the power to require security is framed in broad terms and applies where HMRC considers it necessary for the protection of the revenue at risk. A criminal sanction may apply if a person doesn't comply with a requirement to provide security and the courts may impose an unlimited fine.

It is intended that securities for CT and CIS will follow the existing regime as far as possible, and the power to require security will be framed in similarly broad terms. CIS corresponds quite closely with PAYE in terms of its structure and the frequency of filing and payment obligations, and will fit readily within the existing securities processes. However, the profits-based nature of CT and its calculation by reference to accounting periods that are up to, and most frequently, a year long, raises new issues which may necessitate a more tailored approach.

The consultation seeks input on numerous aspects of the extension, including:

- the forms of security that could be required;
- which entities should be within the scope of the CT security deposit regime;
- whether an instalment approach should be considered; and
- how the amount of security should be calculated.

Alongside this extension, and as announced at Autumn Budget 2017, the government will be looking more widely at options for tackling those who deliberately abuse the insolvency regime to avoid or evade their tax liabilities, including through the use of phoenixism. A separate discussion paper, *Tax abuse and insolvency: a discussion document*, will be published in due course, which will seek views on how to tackle the small minority of taxpayers who abuse the insolvency regime in this way. Extending the current securities provisions to CT and CIS complements that measure as it strengthens an existing tool for protecting future revenues where there is a proven history of contrived insolvency.

The deadline for responses to the consultation is 8 June 2018.

See *Extension of security deposit legislation*, available via bit.ly/2HvMVZF.

### VAT registration threshold: call for evidence

As announced at Autumn Budget 2017, the government has published a call for evidence on the VAT registration threshold. This follows the publication of the Office of Tax Simplification's report on routes to simplification for VAT, which recommended the VAT registration threshold be examined.

The current UK VAT registration threshold is £85,000. It is the highest in the EU (with the average in the EU and the OECD being around £29,000). Although a high registration threshold allows small businesses to avoid the administrative requirements of VAT, it may also encourage businesses with turnover just under the threshold to restrict their growth to remain under the threshold. The government is not minded to reduce the threshold, but is consulting on whether the design of the threshold could be improved to better incentivise growth. The call for evidence seeks views on:

- how the threshold might currently affect business growth;
- the burdens created by the VAT regime at the point of registration, and why businesses might manage their turnover to avoid registering; and
- possible policy solutions, based on international and domestic examples, including the EU's proposal for SMEs.

The call for evidence is open until 5 June 2018. The government would like responses from all interested parties, in particular small businesses that trade near the current VAT threshold.

See *VAT registration threshold: call for evidence*, available via bit.ly/2FPZLog.

## Alternative method of VAT collection: split payment

Following the call for evidence that was announced at Spring Budget 2017, the government is consulting further on the design of a split payment mechanism for online sales.

At Budget 2016 and Autumn Budget 2017, the government introduced a series of measures to tackle online VAT fraud and, in particular, the issue of overseas businesses selling goods to UK consumers without paying the correct UK VAT. The government is looking at introducing a split payment model as a new VAT collection mechanism for online sales as a further measure to tackle online VAT fraud.

A split payment model would harness technology to allow VAT to be extracted directly from transactions at the point of purchase, rather than relying on overseas sellers to account for VAT. This would reduce the cost of enforcing online seller compliance.

The consultation seeks views on:

- who is best placed to effect the split of VAT from the gross payment (the government has concluded that the UK merchant acquirer is best placed, or where the merchant acquirer is not in the UK, the card scheme or card issuer);
- how the process could work in detail;
- the role of online marketplaces;
- the amount to be split (standard rate, flat rate scheme or net effective rate);
- other key considerations, such as whether the mechanism should be applied to all online sales (not just sales from overseas sellers), who remains responsible for the amount of VAT due and how refunds to customers should be processed; and
- how long it might take for organisations to develop new payment technology and implement that technology.

The consultation is open until 29 June 2018. HMRC will also be running a series of workshops to test emerging views over spring and summer 2018 and invites interested parties to get in touch.

See *Alternative method of VAT collection: split payment*, available via bit.ly/2pabuU5.

## The role of online platforms in ensuring tax compliance by their users

HMRC has published a call for evidence on the opportunities and challenges presented by online marketplaces in the context of tax compliance. This builds on the measures in FB 2018 combating VAT fraud in online marketplaces and seeks to extend the discussion beyond VAT.

HMRC's bulk data powers already enable it to obtain data from a variety of businesses so that it can identify non-compliance. However, in the case of online platforms, the data holder may be offshore, and so the data is not easy for HMRC to obtain.

HMRC has also consulted on 'conditionality' (in December 2017), making compliance with certain tax obligations a condition of holding some public sector licences. The new call for evidence suggests that these proposals could, in time, be developed so that tax checks become integrated into the platforms that businesses use to trade.

The questions posed by the call for evidence include:

- what might help users of online platforms to understand their tax obligations;
- what new opportunities online platforms provide for tax avoidance and evasion;
- what data online platforms hold about their users, and whether this data could be utilised to help users understand when they might incur a tax liability; and
- what experience businesses have of the approaches taken in different countries, and whether any of these could be replicated in the UK. For example, in some countries online platforms must provide users with a description of their tax obligations, while other countries provide voluntary or compulsory systems for online platforms to report details about users and their incomes directly to the tax authorities.

As this is a call for evidence rather than a consultation, the government has not committed itself to providing any follow-up within a particular timescale.

See *Online platforms' role in ensuring tax compliance by their users: call for evidence* available via bit.ly/2pbdSdt.

## Cash and digital payments in the new economy

HM Treasury has issued a call for evidence about what the government can do to:

- support the increased use of digital payments across the UK economy by addressing barriers such as transaction costs and a lack of trust in and understanding of electronic payment systems
- ensure that those who need to make cash payments can continue to do so, and that cash remains accessible (e.g. by preventing the closure of ATMs) and secure; and
- crack down on the use of cash for tax evasion and money laundering.

In the context of tax evasion, the government notes that some countries (including France, Belgium and Spain) have placed legal limits, of amounts up to €15,000, on the size of cash transactions. These limits have been motivated by countering the financing of terrorism, but research suggests that cash thresholds can also have an impact on tax evasion and money laundering. The government is seeking views on whether the UK should introduce a similar threshold and, if so, what the level should be.

See *Cash and digital payments in the new economy: call for evidence*, available via bit.ly/2p7HnOb.

### Taxation of self-funded work-related training

As announced at Autumn Budget 2017, the government is consulting on a proposal to extend the tax relief available for work-related training that is funded by employees and the self-employed.

At present, where an employer funds an employee's work-related training, or an employee is reimbursed for the cost of their work-related training by an employer, employers are able to deduct the cost for tax purposes and employees are not taxed on the benefit (ITEPA 2003 ss 250–254). If, however, the employee funds the training and is not reimbursed, employees cannot currently receive tax relief, other than in limited circumstances when the training is an intrinsic contractual duty of their existing employment (see ITEPA 2003 s 336 and HMRC's *Employment Income Manual* at EIM32535). Some respondents to the 2017 call for evidence on employee expenses suggested this position was unfair.

Currently, the self-employed can deduct the costs of training incurred 'wholly and exclusively' for their business where it maintains or updates existing skills (ITTOIA 2005 s 34), but cannot deduct the costs when the training introduces new skills as this is deemed to be expenditure of a capital nature (see ITTOIA 2005 s 33 and HMRC's *Business Income Manual* at BIM35660).

The consultation is taking place at an early stage and does not set out specific options on how to extend the existing scope of tax relief for self-funded work-related training. Instead it asks for feedback on other UK and non-UK efforts of using the tax system to support individuals' training, and sets out high-level objectives and design principles for any proposed reform for comment. Changes to the tax system for employers are outside the scope of the consultation.

The deadline for responses to the consultation is 8 June 2018. The responses will be used to inform future policy development, albeit the government has made no firm decisions about the issues as yet.

See *Taxation of self-funded work-related training*, available via bit.ly/2tNziTg.

### Other publications

The following calls for evidence and consultation responses were also published on 13 March 2018.

#### Tackling the plastic problem

As announced at Autumn Budget 2017, this call for evidence seeks input as to how changes to the tax system can be used to address single-use plastic waste by reducing unnecessary production, increasing reuse and improving recycling. The government asks respondents to consider the whole supply chain, from production and retail to consumption and disposal. The call for evidence closes on 18 May 2018.

See *Tackling the plastic problem*, available via bit.ly/2FLwxGX.

#### Tax treatment of heated tobacco products

Following a consultation (which closed on 12 June 2017), HM Treasury has published a response document which confirms that the government intends to create a new excise category for heated tobacco products. The government plans to publish draft legislation in summer 2018 for technical consultation and to legislate the change in FB 2019. The change will come into effect on royal assent.

See *Tax treatment of heated tobacco products*, available via bit.ly/2n0vMhi.

#### Business rates: delivering more frequent revaluations

Following a consultation on implementing more frequent revaluations (which closed on 8 July 2016), the government has published a summary of responses. The document confirms that the government will bring forward the next property revaluation for business rates by one year to 2021, with three-year revaluations taking effect in 2024. The document states the government has decided not to introduce self-assessment at this stage. Instead, valuations will continued to be carried out by the Valuation Office Agency. The summary of responses also announces that the implementation of the new business rate digital system for local authorities, announced at Budget 2016, will be delayed until after 2024.

See *Business rates: delivering more frequent revaluations*, available via bit.ly/1pKOd9L.

#### VAT, APD and tourism in Northern Ireland

This call for evidence seeks views on the impact of VAT and air passenger duty (APD) on tourism in Northern Ireland. The consultation considers the impact that current VAT reliefs, exemptions and refunds have on tourism in Northern Ireland and whether changing the rate of VAT and APD would have a significant impact on tourism levels. The call for evidence closes on 5 June 2018.

See *VAT, air passenger duty and tourism in Northern Ireland*, available via bit.ly/2FPKtQn.

### Future developments

The chancellor's written statement lists a number of further documents that will be published over the coming months. These include the following.

#### Draft legislation:

- **Tackling construction sector supply chain fraud**: This is a technical consultation on draft legislation for a domestic VAT reverse charge. It follows a consultation at Spring Budget 2017 and government confirmation at Autumn Budget 2017 that the measure will be introduced from 1 October 2019. The new rules are designed to counter 'missing trader' fraud in construction industry supply chains, by shifting responsibility to the customer for paying VAT to HMRC where the customer is a VAT-registered construction business.
- **Transferable tax history for oil and gas**: This is a consultation on draft legislation to introduce a transferable tax history for oil and gas companies. This follows a consultation that was published after Spring Budget 2017.
- **Petroleum revenue tax deduction for decommissioning costs**: This is a consultation on draft legislation, announced at Autumn Budget 2017, to allow a petroleum revenue tax deduction for decommissioning costs incurred by a previous licence holder.

Responses to consultations:

- **VAT and vouchers**: This is a response to the consultation, published on 1 December 2017, on changes to the VAT treatment of vouchers. This change will ensure that when customers pay with vouchers, businesses account for the same amount of VAT as when other means of payment are used. Legislation is expected in FB 2019
- **Large business compliance**: This is a response to the consultation, published on 13 September 2017, on HMRC's process for risk-profiling large businesses, to improve HMRC's business risk review process.

New consultations:

- **Short term business visitors**: This is a consultation on how to simplify the tax treatment of short term business visitors from the foreign branch of a UK company, to ensure that the UK is an attractive location to headquarter a business. This follows HM Treasury's December 2017 response to concerns voiced by the asset management industry.
- **Gaming duty: review of accounting periods**: This is a consultation to seek views on bringing the administration of gaming duty more into line with the other gambling duties.
- **Capital gains tax payment window**: This is a technical consultation on the design of the system requiring CGT due on a disposal of residential property to be paid within 30 days of completion. This follows an original announcement at Autumn Statement 2015 and confirmation at Autumn Budget 2017 that the measure will be introduced.
- **Off-payroll working**: This is a consultation, announced at Autumn Budget 2017, on how to tackle non-compliance with IR35 in the private sector, drawing on the experience of the public sector reform.
- **Profit fragmentation**: This is a consultation, announced at Autumn Budget 2017, on the best way to prevent UK traders or professionals from avoiding UK tax by arranging for UK trading income to be transferred to unrelated foreign entities.
- **Taxation of trusts**: This is a consultation, also announced at Autumn Budget 2017, on how to make the taxation of trusts simpler, fairer and more transparent.

In addition, the government's new consultation status tracker (bit.ly/2GpLtIP) confirms the government's intention to legislate the outcome of the following consultations in FB 2019:

- taxing gains made by non-residents on immovable property (see bit.ly/2B1lvYk);
- corporation tax treatment of lease payments under the new corporate interest restriction (see bit.ly/2Av9ZYB);
- impact of the introduction of IFRS 16 (a new accounting standard for leasing which takes effect from 1 January 2019) on income and corporation tax (see bit.ly/2Aw4Ijw); and
- withholding tax on royalties (see bit.ly/2Apwagm). ■

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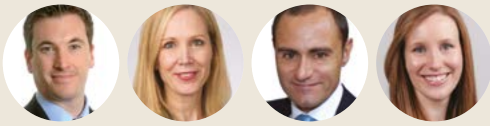
*1. Taxing the digital economy*



Ben Jones, Susan Seabrook, Sebastiano Sciliberto and Georgina Jones (Eversheds Sutherland) review the different unilateral approaches and international efforts to determine a multinational solution.

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Leaving all options open? Sara Luder & Philip Higham (Slaughter and May) examine the Bill which tries to accommodate all plausible outcomes for tax on trade post-Brexit.

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A level playing field? Kirsten Prichard Jones & Rhiannon Kinghall Were (Macfarlanes) examine what's proposed.

*4. The royalties withholding tax consultation*

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*5. US tax reform*

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Briefing

# Private client briefing for March

**Speed read**

**The First-tier Tribunal has considered, in separate cases, the validity of penalties. In *Hills Residential*, an automatic late filing penalty was invalid where the taxpayer had taken all reasonable steps to try to file the return on time; in *Onillon* the FTT considered for the first time the 'reasonable in all the circumstances' defence against a penalty for failure to take corrective action; *HMRC v Tooth* highlights the benefit of making full disclosure to HMRC, even where the legal technical basis for the claim by the taxpayer is controversial, and is later proved to be wrong; and *D J Wood v HMRC* confirms that a penalty for late filing cannot generally be invoked without a prior notice to file having been served.**

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## *Hills Residential*: all reasonable steps taken to file return

*Hills Residential Ltd and Latimer Developments Ltd v HMRC*[2018] UKFTT 0039 was an appeal by Latimer Hill LLP against a penalty of £100 imposed by HMRC for the late-filing of a SDLT return following a £15,000,000 land acquisition. The FTT considered the steps the appellant had taken in applying for a VAT registration number and a unique taxpayer reference number. The SDLT return and payment of tax were due by 24 March 2017 but despite the taxpayer chasing on 2 March, 8 March and 22 March 2017, neither the VAT number nor the UTR had been received by then. HMRC accepted the appellant's contention that the lack of a VAT number was delaying payment of the tax due. The VAT number was eventually received by the appellant on 26 April 2017 and the SDLT return was then filed. The UTR was never received.

A penalty for late filing was issued on 2 May 2017 and upheld on review by HMRC on 15 August 2017. The taxpayer appealed on the basis it had taken all reasonable steps to meet the filing deadline and rather it was HMRC's delay in providing the VAT number that caused the delay in filing. HMRC's guidance confirms that as SDLT is a self-assessment tax, the responsibility for submitting the return rests with the taxpayer, and that if a taxpayer believes it does not have the necessary unique references to be able to complete the return, it should contact the relevant HMRC helpline. The appellant did this, only to be told by an advisor that it should use its company reference number even though (being a partnership) it did not have one. The tribunal considered that the helpline adviser regrettably 'did not seem to have appreciated the difference between a Companies Act company which has a CRN and an LLP which has a different type of number'.

The FTT first assessed the validity of the penalty and found it to be invalid. It criticised the lack of information submitted by HMRC to show two things: (i) 'that a determination was issued and in what form and by whom'; and (ii) that the notice of penalty was served on the liable person. Fatal to its position was that HMRC had failed to demonstrate that a determination had been made by an authorised officer or even a 'live human being'. Judge Thomas referred to his own judgment in *Khan Properties Ltd v HMRC* [2017] UKFTT 830 (TC) (in which he held a determination made by a computer to be invalid) to conclude that the late filing penalty issued in this case was invalid.

Notwithstanding his conclusion that the penalty itself was invalidly determined, the FTT also allowed the appeal on the basis that the appellant's actions were those of a 'prudent person, exercising reasonable foresight and due diligence and having proper regard for their responsibilities.'

### Why it matters

The decision confirms that, although the onus is on the taxpayer to file self-assessment returns correctly and on time, provided the taxpayer takes all reasonable steps to do so in the context of all reasonable circumstances, there cannot be automatic liability on the taxpayer's part for failing to meet the requirements set by HMRC.

## *Onillon*: the 'reasonable in all the circumstances' defence

In *Onillon v HMRC* [2018] UKFTT 33, the taxpayer had entered into a failed tax avoidance scheme. He sought to claim the intended relief by way of a tax refund that would have been due had the scheme worked. The refund was never paid and a follower notice was correctly issued by HMRC setting out the corrective action required. Incorrectly, HMRC also issued an accelerated payment notice in respect of the tax relief that was never refunded. On the basis that the taxpayer knew there was no money owed by him, he did not take the corrective action set out in the notice (which would have included amending and filing his tax return within the prescribed timeframe) and rather, through his advisor, discussed the matter with HMRC. From that discussion, it was the taxpayer's understanding that no further action was required by him as no tax refund had ever been made.

HMRC subsequently issued the taxpayer with a 30% penalty for failure to take the corrective action, which he then appealed. The appellant relied on two grounds of defence: that he did not fail to take any corrective action that he could or should have taken, and that if there was a failure to take corrective action, it was reasonable for him not to take it. The appellant submitted in respect of the latter defence that: it is not reasonable to require the taxpayer to do something that has already been done (i.e. to amend a tax return that has already been amended by HMRC), and that even if no such amendment had been made it was reasonable from the information provided (namely figures produced by HMRC) to assume that that was the case. It was further submitted that it was reasonable for the appellant's solicitor to accept HMRC's statement made by telephone that there was no further action required.

The FTT allowed the appeal on the basis that the taxpayer had done everything that was 'reasonable in all the circumstances' and that irrespective of his technical failure to follow correct procedure and regularise his position with HMRC, the taxpayer should not be penalised.

### Why it matters

The case succeeded on the basis of the 'reasonable in all the circumstances' defence that had not been judicially considered before. The case confirms that the question as to what is 'reasonable in all the circumstances' must be considered objectively but within the legislative context in which it arises. A taxpayer's decision not to take corrective action must be a properly informed choice and something that a prudent and reasonable hypothetical person would have done in his situation in light of all the facts and the legislative context but taking into account the taxpayer's own beliefs and actions. The case thus helps to codify the meaning of 'reasonable in all the circumstances' within the context of FA 2014 s 20. It confirms that even in circumstances where the taxpayer can do more to regularise his position with HMRC, that in itself is not fatal to his position.

## *Tooth*: invalid discovery assessment

In *HMRC v Tooth* [2018] UKUT 38, the taxpayer had created a salary loss by virtue of a tax avoidance scheme that was later disallowed. Due to an software problem, the tax return did not allow him to claim the loss in the right place and so he knowingly entered the claim into another part of the return but provided a full explanation as to the legal basis of the relevant entries. HMRC took the view that this was a standalone claim and issued the relevant enquiry under TMA 1970 Sch 1A. It subsequently realised, by virtue of the case of *HMRC v Cotter* [2013] UKSC 69, that a different enquiry under TMA 1970 s 9A should have been made but the deadline for issue had passed. It therefore issued a discovery assessment on the basis that the tax return contained a deliberate inaccuracy leading to a tax loss.

The FTT decided in the taxpayer's favour and HMRC appealed. The Upper Tribunal took the view that HMRC could not simply switch between statutory grounds just to find a way to challenge the return, and that they had to rely on the correct statutory provision. The fact that the deadline had passed for the s 9A enquiry was irrelevant and did not give HMRC free reign to contrive to find another basis for challenge. The UT also held that it was quite clear from the tax return that the taxpayer had set out his interpretation of the law as the basis for his claim. The fact that his interpretation was technically questionable, controversial, and later taken to be wrong, did not make the return inaccurate when it was filed. Even less could it be said to be a deliberate inaccuracy. In fact, HMRC had made no discovery as there was full disclosure on the part of the taxpayer albeit the legal basis of his claim was incorrect. The UT therefore dismissed HMRC's appeal.

### Why it matters

The judgment in this case might seem surprising given the legal basis for making the claim underpinned what proved to be a failed tax avoidance scheme. Recent cases indicate a trend of the tribunal to try within their remit to provide opportunities for HMRC to challenge cases associated with tax avoidance schemes. This case, however, specifically confirms the favourable treatment a taxpayer might receive where there has been a frank and open disclosure of process, and of his interpretation of the law, even where his interpretation is later proven to be technically incorrect. What was disclosed was a bona fide interpretation of the law and even if it was later proved wrong, the return was not itself inaccurate and certainly not deliberately so.

## *Wood*: whether notice to deliver tax return issued

In *D J Wood v HMRC* [2018] UKFTT 74**,** HMRC levied a TMA 1970 Sch 55 penalty for the late filing of a self-assessment return but the FTT took issue with the fact that HMRC could not produce evidence to show that a notice to deliver a tax return had been issued or served on the taxpayer.

The defence relied upon by the taxpayer on appeal was 'reasonable excuse'. Although that defence was discounted by the tribunal, they still allowed the appeal on the basis that Sch 55 had been wrongly and prematurely invoked in the first place. Relying on the wording of TMA 1970 s 8(1) which provides that a taxpayer 'may be required by a notice' to file a return, the tribunal opined that if 'Parliament intended that the obligation to deliver … a return was an absolute obligation, … there seems to be no reason why there should by any reference to a notice requirement at all.' The tribunal conceded that there can be cause to impose penalties by reference to failing other statutory obligations such as the s 7 requirement to notify chargeability. However, penalties aligned to such other sections would be made by recourse to specific statutory provisions, rather than the Sch 55 provision in question.

### Why it matters

One might consider that the occasions when this set of circumstances, and the corresponding favourable FTT decision, will apply are limited given there are numerous ways by which a filing requirement automatically arises. That said, in this case there was no such automatic obligation, and it could potentially invite scrutiny of all cases where taxpayers have unilaterally decided to complete a tax return without notice but outside the relevant time limits.

## What to look out for

- **Consultation on time limit extension for assessing offshore non-compliance:** Following the initial announcement in the Autumn 2017 Budget, a consultation opened on 19 February 2018 on the proposal to implement a new minimum tax assessment time limit of 12 years for assessing offshore non-compliance. It is intended that the time limit will apply to assessments of income tax, capital gains tax and inheritance tax (and, potentially, corporation tax). The proposed change is intended to address situations where the current assessment time limits of four and six years are not sufficient to establish the full position. The consultation closes on 14 May 2018.
- **New special committee on financial crime, tax evasion and tax avoidance:** MEPs have voted in favour of a new committee set up to target financial crime, tax evasion and tax avoidance which was proposed in response to the paradise papers leak of last year. They have also voted in favour of further proposals that will place disclosure obligations on any intermediaries seeking to promote aggressive cross-jurisdictional tax schemes. ■

**For related reading visit www.taxjournal.com**

- Cases: *HMRC v R Tooth* (14.2.18)
- Cases: *D J Wood v HMRC* (27.2.18)
- Discovery (Andrew Hubbard, 8.5.17)

# Initial coin offerings and VAT

**Etienne Wong**

Old Square Tax Chambers

Etienne Wong has been advising on VAT since 1989, with particular focus on finance, real estate, M&A, private equity, funds, e-commerce, outsourcing, renewables and new media. He is a barrister with Old Square Tax Chambers at 15 Old Square. Email: ewong@15oldsquare.co.uk; tel: 020 7242 2744.

**My client Bob lives in the UK. He is not a taxable person for VAT purposes. In September 2017, he bought some bitcoins. He is an investor and does not trade in them. He is now considering investing some of his bitcoins in an (as yet to be identified) initial coin offering (ICO) – a wholly digital means of raising finance – subscribed for in bitcoin (or other cryptocurrencies) rather than fiat currencies. Bob has been looking at ICOs based in Switzerland, Singapore and Hong Kong, and wants to know what (if any) VAT issues would arise if he were to proceed with such an investment.**

As a bitcoin investor (rather than trader), Bob would, whenever he disposes of his bitcoins, only be exercising his right *qua* owner; therefore, when he invests in the ICO, he himself would not be making any supplies for consideration for VAT purposes (*Wellcome Trust* (Case C-155/94)). The question is whether the issuer will be making any supplies to him, and if so, whether those supplies will be subject to VAT.

An ICO is often described (not entirely accurately) as a digital initial public offering (IPO), where instead of shares, tokens are issued. However, unlike shares, tokens do not generally represent an equity stake in the project that is the subject of the ICO or yield dividends. The characteristics of tokens vary from ICO to ICO. They may themselves be a new cryptocurrency, or they may confer rights such as the right to:

- share in any future profits from the project;
- vote on specified matters affecting the project; or
- purchase goods or services within the environment created under the project.

The answer to Bob's question depends on the precise nature of the tokens he is acquiring.

The issue of shares or securities for the purpose of raising capital falls outside the scope of VAT (*Kretztechnik* (Case C-465/03)). If, therefore, the tokens are in substance comparable to shares or securities, their issue to Bob should also fall outside the scope of VAT (see, by analogy, *MBNA* [2006] EWHC 2326).

Similarly, if the tokens are themselves a new cryptocurrency, their issue to Bob should be treated in the same way as any sale of cryptocurrencies; i.e. exempt (where there is a supply for consideration for VAT purposes) (*Hedqvist* (Case C-264/14)).

If, in substance, the tokens do not equate to shares, securities or currency, then (assuming the issuer is a taxable person within the meaning of the Principal VAT Directive (PVD) article 9) their issue would not only give rise to a supply for consideration, the supply is also likely to be taxable for VAT purposes; however, where the only right the tokens confer is a right to payment (e.g. a share in future profits), the supply should be exempt within PVD article 135(1)(d), which applies to 'transactions … concerning … payments, transfers, debts'.

Where the tokens confer a number of different rights, the question would also arise as to whether there is only one supply or multiple supplies. The issue of the tokens would be a single composite supply where:

- from the holder's perspective, any of the rights constitutes an aim in itself (with the others being merely means of better enjoying it) (*CPP* (Case C-349/96)); or
- all the rights are so closely linked that they form, objectively, a single, indivisible economic whole that is artificial to split (*Levob* (Case C-41/04)).

If a single subscription amount is payable, that may point to a single composite supply, but it is not determinative – it very much depends on the facts.

Because the tokens are immaterial, their issue would be a supply of services (and not goods (PVD articles 14 and 24)), and the supply would be subject to UK VAT if made in the UK.

Because Bob is not a taxable person for VAT purposes, he is not a 'relevant business person' (within the meaning of VATA 1994 s 7A(4)). Therefore, prima facie, the supply would be treated as made in the country where the issuer belongs (VATA 1994 s 7A). In this case, this would be Switzerland, Singapore or Hong Kong. The position would be different where the issue of the tokens amounts to a supply of 'electronically supplied services' (VATA 1994 Sch 4A para 15). In such a case, the supply would be treated as made in the country where the recipient (Bob) belongs; i.e. the UK (VATA 1994 s 9).

What constitutes 'electronically supplied services' is not defined – only examples are set out in VATA 1994 Sch 4A paras 9(3) and (4). HMRC regards them as: 'e-services which are automatically delivered over the internet, or an electronic network, where there's minimal or no human intervention … where the [transaction] is essentially automatic, and the small amount of manual process involved doesn't change the nature of the supply from an e-service' (see HMRC's guidance *VAT: businesses supplying digital services to private consumers*, available at bit.ly/1rfBHPf).

The issue of the tokens to Bob would more than likely constitute a supply of 'electronically supplied services' made in the UK. Assuming the issuer does not have any establishments in the EU, it may be required, or it may choose, to register for VAT in the UK pursuant to VATA 1994 Sch 1A or 3B.

Where the tokens confer the right to purchase goods or services, they may amount to 'face value vouchers' (VATA 1994 Sch 10A para 1). If they do, the tax point for the supply would be when:

- Bob's bitcoins are received by the issuer (where the tokens constitute 'single purpose vouchers'; i.e. 'face value vouchers' that confer a right to goods or services of one type only that are subject to a single rate of VAT (VATA 1994 Sch 10A para 7A)); or
- the tokens are 'redeemed' (where they are not 'single purpose vouchers').

(HMRC is currently consulting on changes to the VAT treatment of vouchers in light of Council Directive (EU) 2016/1065.)

In addition to the above, Swiss or Singaporean goods and services tax (GST) may arise as well. (There is currently no VAT or GST in Hong Kong.) Also, should any VAT or GST be payable, whether the cost would be borne by the issuer or passed to Bob will need to considered by reference to applicable law and the relevant documents. ■

# One minute with...

## Isobel d'Inverno

Brodies LLP

Isobel d'Inverno is the head of corporate tax at Brodies LLP. She advises clients on corporate acquisitions, disposals and reconstructions as well as complex property transactions, and has a particular expertise in the land and buildings transaction tax (LBTT), the Scottish SDLT. Email: isobel.dinverno@brodies.com; tel: 0131 656 0122.

**If you could make one change to tax law or practice, what would it be?**
It would be great if there was less 'secret knowledge' about HMRC's views on some of the more complex areas of tax. At the present, there are a lot of HMRC interpretations which haven't made it into the HMRC manuals, so only those who frequently practice in that particular area are aware of the accepted view. Greater transparency about HMRC's views would be helpful, and save time for all concerned. The same applies to Revenue Scotland and the new Welsh Revenue Authority, of course; perhaps there is an opportunity for both those organisations to make sure their guidance deals with all relevant points.

**Are there any new rules that are causing particular concern?**
From 1 April 2018, tenants of commercial property in Scotland will have to submit additional LBTT lease returns. The LBTT system aims to ensure that LBTT is paid on the rent actually paid under the lease, so the initial returns are based on estimates of the rent, but further review returns have to be submitted every three years, including a revised LBTT calculation. Any additional LBTT has to be paid at that stage, or a repayment claimed from Revenue Scotland.

LBTT was introduced on 1 April 2015, so the three yearly returns for the first LBTT leases will be due soon. There are likely to be tenants caught unawares, though Revenue Scotland has been making good use of roadshows and social media to make sure that all tenants are aware of the requirement to submit three yearly returns.

There is also some concern about an emerging very restrictive Revenue Scotland view about when land is non-residential for LBTT purposes. A purchase of mixed residential and non-residential property is all subject to LBTT at the lower non-residential rates, which can lead to a considerable tax saving, but there seem to be suggestions that to count as non-residential, something very commercial has to be going on. This doesn't seem to be supported at all by the legislation, and a lot of tax can be involved.

There is some concern about an emerging very restrictive Revenue Scotland view about when land is non-residential for LBTT purposes

A simple solution to these issues, which are also becoming a problem in relation to SDLT, would be to apportion the consideration between residential and non-residential land. LBTT already does this for the 3% surcharge, which is charged on the residential element of mixed purchases. It would not be difficult to extend this treatment to residential and non-residential land in general, with each part being taxed at the relevant rate.

**Is NIC fair in the modern world?**
The trouble with NIC is that it discriminates against businesses with a large workforce, as compared with the growing number of online or digital businesses, and those which are increasingly automated. Merging NICs with income tax seems to have been consigned to the 'too difficult' pile, but a number of other approaches are being talked about now and deserve consideration. These include, for example a robot tax, or a more general welfare tax payable by all companies, not based on payroll/number of employees, and these all need to be considered against the background of current initiatives to impose fair taxation on digital businesses. It is a particular issue for the Scottish government, of course, because Scotland has control over the income tax rates, but not over NICs.

**You might not know this about me…**
I lived in Russia for two years as a child, and went to Russian school. Doing maths in Russian, with all its grammatical complexities, was much harder than tax! ■

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# What's ahead

**March**

**16** **Regulations:** The Research and Development (Qualifying Bodies) (Tax) Order, SI 2018/217 comes into force.

**19** **Compliance:** Pay PAYE, NI, construction industry scheme and student loan liabilities for month ended 5 March 2018 if not paying electronically; file monthly CIS return.
**Consultation:** Comments close on OECD consultation on the use of 'residence by investment' or 'citizenship by investment' schemes (see bit.ly/2EBfaEY).

**21** **Compliance:** File online monthly EC sales list; submit supplementary intrastate declarations for February 2018.

**22** **Regulations:** The Capital Allowances (Energy-saving Plant and Machinery) Order, SI 2018/268 come into force.
**Compliance:** PAYE, NI and student loan liabilities should have cleared HMRC's bank account.

**23** **Consultation:** Comments close on LBTT first time buyers' relief.

**28** **Consultation:** Comments close on draft regulations updating the taxation of investment returns from basic life assurance and general annuity business.

**31** **Legislation:** Disincorporation relief expiry date.
**Corporate:** Deadline for corporate interest rules election (bit.ly/2EdyBHW).
**VAT:** Last day for evidence in writing on *Revenue and Customs Brief 2/2018* (VAT treatment of advanced learner loans).
**Regulations:** The Greenhouse Gas Emissions Trading Scheme (Amendment) Regs, SI 2018/306 comes into force.
**Compliance:** Companies House to receive accounts of private companies with 30/6/17 year ends and public limited companies with 30/9/17 year ends; final date to reclaim tax paid by a close company on certain loans to a participator under CTA 2010 s 455; see taxjournal.com/articles/whats-ahead for full list of other compliance deadlines.

*For a 'what's ahead' which looks further ahead, see taxjournal.com (under the 'trackers' tab).*

**Coming soon in Tax Journal:**
- CBCR and TP document: what's next?
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| **Tax manager**<br>ForrestBrown<br>£competitive + benefits<br>Bristol<br>ForrestBrown | The role involves managing your own portfolio of clients from across a range of exciting industries, giving strategic tax advice and submitting robust R&D tax credit claims to help clients in the UK. The applicant should be CTA or ACA qualified, and preferably a solid communicator with excellent time management skills. **Ref TJ042** |
| **In-house corporate tax role**<br>Posted by Nebula Partners Ltd<br>London<br>£64,000–£100,000<br>nebula | There is a female short listing preference for this front office transactional tax, regulatory and commercially led structuring. The principal investments and trading arm of a major investment bank offers a front office entry role to a tax ACA with 12–24 months post qualified experience. **Ref TJ043** |
| **Tax technical partner: OMB tax**<br>Posted by Michael Page<br>£100,000–£151,000<br>London<br>Michael Page Tax | Tax technical partner with an OMB specialism required for mid-tier firm in London. The applicant should have at least 15 years' tax experience in a professional services environment and have exceptionally strong tax technical knowledge. No fee following is required. **Ref TJ044** |
| **Assistant group tax manager**<br>Rotork<br>£35,000–£45,000 + bonus + benefits<br>Bath<br>rotork | Qualified accountant or ATT holder who can demonstrate some experience of corporate tax calculation and compliance under IFRS sought for newly created role with Rotork plc, a highly successful FTSE 250 and international engineering company with an enviable track record of growth and profitability. This is a wide ranging position working closely with the Group Tax Manager and other members of central finance. **Ref TJ045** |

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